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Nos. 92-1384 and 92-1839

In The
Supreme Court of the United States
October Term, 1993

BARCLAYS BANK PLC,
Petitioner,
vs.
FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

COLGATE-PALMOLIVE COMPANY,
Petitioner,
vs.
FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

On Writs of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

BRIEF OF AMICI CURIAE IN SUPPORT OF RESPONDENT FRANCHISE TAX BOARD BY THE CALIFORNIA TAX REFORM ASSOCIATION AND CALIFORNIA TEACHERS ASSOCIATION; CALIFORNIA FEDERATION OF TEACHERS;
(Continued on inside cover)

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QUESTIONS PRESENTED

1. Whether a political decision by California's citizens to impose an effective, nondiscriminatory corporate income tax to fund public services which support and encourage international trade should be reversed as an undue burden under the Commerce Clause?

2. Whether the Court should ignore the treaty process to make new foreign policy, nullifying State budget and tax laws, in the absence of clear and convincing proof that the State tax is too burdensome or discriminatory?

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

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INTEREST OF *AMICI* [1]

The California Tax Reform Association is a California nonprofit organization which represents the interests of the citizens of California in sound tax policy. It was incorporated in 1977 with the support of a coalition of citizens groups. It is supported through public contributions and foundation grants. The Association has participated in the legislative process and litigation about California's use of the unitary accounting method to allocate profit for the past 15 years. It is uniquely able to present arguments on the issues before this Court from the perspective of the California citizen/taxpayer.

Other *amici* are unions and associations which represent both public sector and private sector employees who are part of California's work force. The members of these organizations are the individual taxpayers who will have to bear the direct cost of either additional taxes or lost services if the Petitioners are successful in their pleas to this Court. These *amici*, and the individuals which they represent, have a direct and immediate concern in the outcome of these cases.

SUMMARY OF ARGUMENT

Arguments advanced by Barclays and its *amici*, characterizing California's tax as burdensome, ignore the facts. California law, regulations and the supporting

[1] Pursuant to Rule 37, consent of the parties has been requested and obtained. Copies of the written consents will be filed under separate cover.

regulatory and administrative decisions deal simply, and directly, with the fictitious "chamber of horrors" advanced in their briefs.

California's worldwide combined reporting system (WWCR) enhances, rather than burdens, international trade. The California corporate tax, including WWCR, is an essential element of a successful State policy to enhance international trade and commerce.

The decision to tax all corporations doing business in California on a worldwide combined basis was part of a conscious policy by the citizens of California to develop international trade and foreign investment through public spending on education, training and physical infrastructure. Tax revenue from multinational corporations was an essential element of the plan. To be successful, the tax had to maintain a level playing field for all competitors, whether wholly domestic or multinational.

The investment decisions and the tax policy paid off handsomely. California became a favored site for high technology industry. Foreign investment soared, imports and exports soared. The economy of California became larger than that of most sovereign nations. California's effective taxation of all corporations provided a significant portion of the revenue essential to support this growth and development. It also provided a level playing field for wholly domestic competitors.

The history of public investment in support of foreign trade and the resulting pattern of spectacular growth in foreign trade and investment is inconsistent with the argument that the tax is an undue burden on international commerce.

The foreign policy powers of the United States are delicately balanced between the Executive and the Congress.

The Executive has the broad power to act on diplomatic matters. The right to make treaties, however, is sharply limited by the ratification process. To become the supreme law of the land, a treaty must be ratified by a two-thirds vote of the Senate. The Senate has debated and explicitly rejected a treaty which would have changed California's WWCR system, and the Executive Branch acquiesced to that rejection.

Having failed at the constitutional process, multinational corporations and foreign governments now ask this Court to take over the role of arbiter of foreign policy in the international tax arena and nullify California law. But there should be no federal preemption of State law, absent legislation or a treaty. The Commerce Clause does not protect foreign corporations from paying nondiscriminatory State taxes.

I. THERE IS NO CREDIBLE EVIDENCE THAT CALIFORNIA'S TAX ACCOUNTING METHOD BURDENS FOREIGN COMMERCE.

A. The Claimed Million Dollar Costs of Compliance Are An International Red Herring.

Barclays, and a number of its *amici*,[2] argue that either compliance with WWCR is virtually impossible or so expensive for foreign-based multinationals as to constitute discriminatory treatment. They claim international businesses do not otherwise keep the data required for WWCR. Their assertions are not correct.

[2] See Briefs of Reuters Limited, Confederation of British Industry, Council of Netherlands Industrial Federations, Federation of German Industries and the Association of German Chambers of Industry and Commerce, Japan Tax Association and Banque Nationale De Paris.

A WWCR calculation requires just seven basic numbers: 1) worldwide income, 2-4) worldwide property, payroll and sales, and 5-7) California property, payroll and sales.[3] Jerome Hellerstein, a venerated authority on state taxation, noted:

> The fact is that much of the data required for formulary apportionment already are being gathered by multinationals for business, financial and reporting purposes, for tax returns, and for SEC and other regulatory agency filings. Foreign currency transactions must be converted into dollar figures for such purposes. Furthermore, with the increasing globalization of industry and of the worldwide accounting firms that service multinational enterprises, and the computerization of accounting records, compliance with apportionment requirements on a worldwide basis is not the formidable task it once was. *Federal Income Taxation of Multinationals: Replacement of Separate Accounting with Formulary Apportionment*, Tax Notes, August 23, 1993, at 1142.[4]

Barclays' and its *amici*'s arguments also fail when their claims are compared to the text of the California regulation,

[3] The source of such numbers for the Barclays Group is in the record. See Exs. 51E, 51F, 51G, 51K, 51Q, 51R, 51S, and 51U. Respondent's expert witness, John Shank, in his testimony at trial, illustrated how various exhibits could be used to construct a WWCR. Reporter's Transcript 2039-2097.

[4] For additional comments on the compliance arguments, see Benjamin F. Miller, *A Reply to "From the Frying Pan to the Fire,"* State Tax Notes, September 27, 1993, p. 705.

§ 25137-6.[5] Barclays Joint Appendix (BJA) Ex. 12, BJA-50-57.

1. Separate books are not needed.

First, the claim is made that a separate set of books and records, stated in California accounting terms, must be established. For example, the *amicus* brief of the Confederation of British Industry at page 14 states:

> Thus, in practical terms, to comply fully with worldwide combined reporting a foreign multinational would have to keep a separate set of books for each foreign corporation using the accounting rules of each WWCR jurisdiction in which any member of the group operates.

Barclays and Reuters merely imply that a separate set of books is required. Reuters at p. 3, states:

> It is the international norm that a multinational enterprise keep all of its books and records in conformance with the requirements of its home country. It is *not* the international norm that a multinational enterprise keep *all* of its books and records in accordance with the tax and accounting requirements of *every* country in which it does business. (Emphasis in original.)

They create the impression, without saying so directly, that WWCR requires a separate set of books and records. The care Reuters and Barclays show in their briefs is understandable. Both have direct filing experience with the States: Barclays with California, and Reuters with New York.

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[5] The California regulation is an adaptation of 26 C.F.R. §1.964-1. If Petitioner Barclays' allegations that the California regulation violates the Due Process Clause because of vagueness and the lack of reviewable standards are accepted, then the federal regulation apparently is also invalid.

In Barclays' case, the California courts found that the actual cost of compliance, for a worldwide combined report for Barclays Bank International, as evidenced by the bills it received from a major accounting firm, was $900 to $1,250 annually.[6] The returns were acceptable to California except as to the scope of the unitary business.

Reuters, a United Kingdom corporation, filed returns with New York State on an apportioned basis for decades before their sudden assertion that the returns would cost in excess of a million dollars annually to prepare.[7] The New York courts found Reuters' claim disingenuous, based on their prior filing experience and the fact that they were able to file their "million dollar" return within ten days of learning that New York was going to require them to file. *Reuters Ltd. v. Tax Appeals Tribunal*, No. 186, slip op. New York Court of Appeals (N.Y. Oct 12, 1993).

California's regulation does not require that separate books and records be maintained. Regulation § 25137-6, as its starting point, uses either "a profit and loss statement prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained," Ex. 12, BJA-50, (b)(1)(A), or "the consolidated profit and loss statement prepared for the related corporations . . . for filing with the Securities and Exchange Commission . . . [or] for reporting to shareholders. . . ." BJA-51, (b)(2). Adjustments are then made to these statements, if material, BJA-54, (b)(3)(C), for differences between foreign and United States Generally Accepted

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[6] Appendix to the Petition, D-19, fn. 9.

[7] Affidavit of Michael J. Canty, Financial Manager — Taxation of Reuters, Ltd., submitted as evidence in the New York matter.

Accounting Principles (GAAP) and California tax accounting standards. A second and separate system is not required, nor even suggested.

2. The accounts need not be in English or in dollars.

The claim is made that the accounts must be kept in dollars and in English.[8] This is incorrect. Regulation § 25137-6 provides that the calculation of income, Ex. 12, BJA-51, (b)(1)(D) and (b)(2), and the apportionment factors, BJA-55, (c)(1)(E), and BJA-56, (c)(2)(C), are to be made in the currency of the parent company. There is no requirement about which language a reporting firm must use in its accounting records. Use of the language of the parent company is implicitly acceptable. In any event, the consolidated accounting records of Barclays are maintained in English.

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[8] "Reports also must be in English and in U.S. dollars." *Amicus* brief of Confederation of British Industry, p. 12.

"[A] foreign based multinational corporation will not ordinarily have to restate its accounts in accordance with the accounting principles of the United States or one of its states, nor need to translate its accounts into U.S. dollars or all its records in English. WWCR requires such restatement and translation, . . ." *Amicus* Brief of Council of Netherlands Industrial Federations, p. 5-6.

"WWCR requires corporate taxpayers to provide details of taxable income for worldwide operations translated into English and adjusted to U.S. and even specific state taxation accounting principles and U.S. currency." Amici brief of Federation of German Industries and Association of German Chambers of Industry and Commerce, p. 7.

Barclays also suggests, that in order to file under WWCR, it must maintain its records in United States dollars and in English. Barclays Opening Brief, p. 44.

3. Conforming foreign financial statements to the United States Generally Accepted Accounting Principles (GAAP) are routinely required.

The claim is made that a United States GAAP conversion is not routinely made for other purposes.[9] These claims are false. First, there is no requirement that accounting records be maintained in accordance with United States GAAP. There is, however, a requirement to convert the regularly maintained records to United States GAAP. But adjustments are to be made only if material. Ex. 12, BJA-54, (b)(3)(C). If the adjustments are not material, they do not have to be made.

Further, U.S. GAAP statements are required for companies which trade on United States security exchanges. In this case, Barclays had, in fact, prepared United States GAAP statements for other purposes. It prepared a prospectus that was used to market its securities here. Stip. ¶ 51 and Ex. 51G, BJA-40. Examination of the Barclays prospectus shows only five material differences between U.S. GAAP financials and the United Kingdom version. Furthermore, trial testimony, by Barclays' own expert witness, established that of the GAAP differences identified, only one had significance for California tax purposes and that the information for the adjustment was readily available. RT 1004-1012. U.S. GAAP statements are also frequently required of foreign-based businesses by United States banks as a condition of getting a loan.

It should also be noted that following the Bank of Credit and Commerce International scandal, state and federal bank regulators have tightened the reporting and accounting requirements for international banks seeking to do business in

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[9] See footnote 8.

the United States. Banks must show their sources of capital and the full financial structure of their affiliated companies. These requirements far exceed the requirements California imposes in connection with its tax returns. See, The Foreign Bank Supervision Enhancement Act of 1991, P.L. 102-42, Title 2, Subtitle A.

4. WWCR fairly allocates bank profits.

One *amicus*, Banque National De Paris, hereinafter Banque, claims that currency exchange accounting problems arise under California WWCR. Banque's claim ignores the fact that the California regulation recognizes the difference between domestic and foreign companies by allowing each of them to determine income and exchange factors in the currency of the parent company.

Banque complains, pp.7-10, that a United States bank and a French bank will have different profits and losses, as expressed in dollars, when the United States bank makes a loan in dollars and the French bank makes a loan in francs because the relative values of the franc and dollar change over time. The assertion is correct, but the conclusion drawn from it is wrong. Their incomes are different. The French bank calculates its income in francs, and the United States bank calculates its income in dollars. The French bank will be taxed fairly under California's regulations because it will report its profitability in the currency of the French parent, the French franc.

For example, if a United States bank makes a franc loan, there are two calculations which must be made to determine income. First, there is the interest and fee profit on the loan itself. Second, there is the profit or loss on the foreign exchange transaction when the bank makes the French franc loan. That will be determined when the loan is repaid. Similarly, a French bank which makes a dollar loan also has

an exchange transaction to account for in determining income. Not surprisingly, the exchange transactions will yield a different result for each bank during the same period. If the dollar strengthens, the United States bank has an exchange loss on lending francs and the French bank has an exchange gain on lending dollars. As long as both transactions are accounted for in the currency of the parent, the net result will be equivalent.

Banque cites two compliance concerns, pp. 4-6. The first is a contrived example involving California's bad debt rules. Under California law, banks and financials are allowed to take a deduction under either the specific charge-off method (a loss is taken when a loan is written off) or under the reserve method (past experience is used to estimate future losses, and a loss is allowed even though it is not yet incurred). In neither circumstance is the accounting particularly complex.[10] The specific charge-off speaks for itself, and the reserve method merely uses past charge-offs to predict future experience. The experience factor for California purposes is based on either three or six years' of experience. Banque complains about neither of these methods. Its example is based upon a facts-and-circumstances exception which allows for a deduction for more than past experience would allow if present circumstances indicate it is appropriate. Furthermore, the procedure discussed is not the only means of establishing the need for an additional reserve but merely one method of showing the need for an additional deduction.

Banque's second compliance concern deals with the establishment of historic cost of fixed assets (the reference to

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[10] In point of fact, Barclays uses the reserve method for accounting for bad debts for its financial reporting purposes based upon five years' of experience. Ex. 51E, p. 29.

financial assets appears to be included for purposes of obfuscation rather than relevance). Banque's complaint is based upon the assumption that foreign multinationals do not keep consolidated books and records prepared in a manner similar to that used in the United States. Whatever the case may be with Banque, it is not the case with Barclays. Barclays' published financial statements allow for the determination of the value of fixed assets at historic cost expressed in Sterling.[11]

Banque's other complaints are equally contrived. For example, the three elements of disproportionality on pages 11-12 of Banque's brief assume the United States tail will wag the foreign dog because they assume that all the calculations must be done in dollars. Banque ignores the fact that the California regulation provides for factor and income calculations to be made in the currency of the parent company. The primary reason for this approach was to look at the entire corporation fairly from the perspective of its home country.

WWCR will give a much fairer picture of a bank's California profit precisely because it ignores the details of the individual transactions and looks for a fair apportionment of the overall result. If California were to use the transactional system, it would be mired in the same arguments Banque raises in its brief. In that case, the bank's arguments would

[11] United Kingdom GAAP allows for the revaluation of fixed assets. Barclays has taken advantage of this treatment. When assets are revalued, a reserve is established as a Note to the Financial Statements which includes the amount of the revaluation. See Ex. 51E. This reserve can then be used to adjust balance sheet values back to original cost and to adjust depreciation for income statement purposes. Testimony of Bernard Caldwell (expert witness called by Barclays), RT-1012.

be used to explain, transaction by transaction, why there was no income in California.

WWCR limits the need for time-consuming and expensive audits to determine income. This facilitates trade, it does not limit it.

B. The "Burdens" Imposed Upon Corporate Taxpayers Have Allowed California To Attract Foreign Investment.

1. California has attracted international investment.

If California were a separate country, its economy would be the seventh largest in the world. It has a diverse regional economy, characterized by advanced technological capabilities, a vast and expanding international market and, until recently, rapid rates of economic growth. Among States and regions of the United States, it has among the highest levels of integration with the world economy; it leads the nation in exports as a percentage of its gross domestic product[12] and in direct foreign investment.[13] In fact, the extent of the internationalization of the California economy is far greater than that of the U.S. as a whole. Thus, in terms of public policy adaptation to the growing internationalization of the economy, California's economy is on the cutting edge.

Another feature of California's economy has been its high rate of public sector investment. Rapid economic growth has been accompanied by public investment in universities and schools, highways and mass transit, water projects and parks,

[12] *Foreign Direct Investment in California*, a joint report of California's Trade and Commerce Agency, the Office of Foreign Investment, and the Office of Economic Research, November 1993, p. 7.

[13] *Ibid.*, pp. 12-15.

libraries and health facilities. For several generations, its publicly supported system of higher education has been unparalleled in the world, particularly in the range of educational opportunities afforded its citizens. Historically, Californians have paid taxes at rates higher than in most parts of the United States in order to stimulate or at least stay abreast of rapid economic and population growth.

Small wonder, then, that multinational companies have sought to be active participants in the California economy. California has continually led the nation in net foreign investment. For example, virtually half of all Japanese investment in the United States during the 1980's was in California, a proportion far higher than one would expect from the size of its economy, which is approximately 12 percent of the U.S. economy.[14]

Japan is the leading source of foreign investment in California with 33.4 percent of the total in 1991.[15] The total book value of Japanese investment in California was $27.3 billion.[16] The next largest sources were the United Kingdom with $11.6 billion and the Netherlands with $11.1 billion.[17] Other countries have become increasingly important as sources of investment. For example, direct investment from Taiwan, Hong Kong, Singapore and South Korea grew collectively by 90 percent since 1988.[18]

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[14] *Ibid.*, p. 10.

[15] *Ibid.*, p. 5.

[16] *Ibid.*, p. 4.

[17] *Ibid.*

[18] *Ibid.*, p. 6.

When a company, such as Barclays, makes a decision to enter the California market, it immediately has access to the educated labor force, the technological capabilities, the transportation facilities, the markets, and the communications infrastructure which California taxpayers have helped pay for.

When a multinational corporation invests in a State, it becomes a taxpayer and a corporate citizen. As a taxpayer, it assumes the obligation to contribute to the maintenance of the public sector investments from which it benefits. It knows the tax structure and policies it will face before it takes the first step. It is also able to express its concerns in the political process about the business climate in which it has chosen to operate. California's legislators and governors are highly attuned to the concerns of those who do business in the State. The business community is influential in California's political processes.

Many of the foreign investors compete directly with California-based corporations and with each other in the California market. If some multinational corporations are given the opportunity to game the international tax system while wholly domestic corporations cannot, an essential attraction of the State — a level competitive playing field — will be destroyed and wholly domestic businesses will be put at a severe competitive disadvantage.

2. California's tax structure allows it to effectively deal with an increasingly complex international economy.

As tax collector for a highly internationalized, advanced information economy, the Franchise Tax Board has continuously improved its techniques of tax enforcement. Court decisions and administrative practice have moved the system from a relatively simple past to the complexities of

modern business enterprises.[19] If California were forced to adopt the arm's-length method used by the federal government, it would be even less able to collect taxes from multinational corporations than the federal government is because of the disparity of resources — and, the federal government's efforts are admittedly inadequate to the task.[20]

3. The California Bank and Corporation Tax, which is based upon use of WWCR, provides State revenue in excess of $5 billion dollars that is essential to the creation of the infrastructure and skilled labor pool which has made California an attractive place to invest.

The California Bank and Corporation tax is the third largest source of revenue for the State's general fund. It is expected to raise $5.1 billion, or 12.4 percent of the State's general fund revenue in 1994-95. Personal income tax is expected to account for more than $18 billion. Sales tax will add $12.7 billion.[21]

The general fund supports the State's educational system. In the 1994-95 budget, a budget which is sharply reduced from previous levels because of the State's, and in fact the world's, continuing economic problems, 9.8 percent will go

[19] Benjamin F. Miller, "Worldwide Unitary Combination: The California Practice," *The State Corporate Income Tax*, Hoover Institute Press, Stanford University, 1984, at 132.

[20] Lobel, Banta & Gueron, *Barclays: A Test of the Administration's Willingness to Collect Taxes From Multinational Corporations*, Tax Notes, June 28, 1993, at 1841; John B. Judis, *Tax Brake, Clinton's Corporate Giveaway*, The New Republic, August 23, 1993, at 15.

[21] *Governor's Budget Summary 1994-95*, Pete Wilson, Governor, State of California, Sacramento, pp. 89-95.

to higher education and 44.2 percent will support education from grades K-14.[22]

The skilled work force produced by the excellent California university system attracts foreign investors.[23] Of the total foreign investments made in the United States in the field of electronics and electric equipment manufacturing, 13.5 percent was in California. Of the foreign investment in instrument manufacturing in the United States, 10.8 percent was made in California.[24]

Despite high tax rates, foreign investors are continuing to come to California to take advantage of the skilled work force. While the growth in foreign investment in California slowed from the very rapid rates of the 1980's, in 1991 it continued at 8 percent over prior years.[25] The 8 percent growth in investment was achieved despite a severe statewide recession, economic problems in the source countries, and the existence of high tax rates.

[22] *Ibid.*, p. 80.

[23] *Foreign Direct Investment in California, op. cit. supra*, p. 1.

[24] *Ibid.*, p. 8.

[25] It is ironic to note that California enjoyed its greatest growth with respect to international investment in the years prior to 1988 when it moved from mandatory worldwide combined reporting to elective water's-edge reporting.

II. FOREIGN GOVERNMENTS AND CORPORATIONS SHOULD NOT BE INVITED TO USE THIS COURT TO CHANGE A SETTLED FOREIGN POLICY OF THE UNITED STATES WHICH IS THE PRODUCT OF ITS POLITICAL PROCESSES.

The Constitution gives the Executive Branch the broad power to handle the diplomatic relations with foreign governments, while it strictly confines any use of foreign policy power to override State and federal law to the treaty process. "[T]reaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; . . ." U.S. Const., art. VI, cl. 2.

> It is to be noted further that for the United States *treaty* law is not just the "supreme Law of the Land," but that it comes into being through a singularly exacting sequence. Treaties are entered into by the United States with other nations, either directly or through adherence to a common document. They are signed by a member of the executive branch. Thereafter the Senate of the United States must by resolution, two-thirds of the senators present concurring therein, give its advice and consent to ratification. This advice and consent having been given — by an extraordinary majority — the president then ratifies and confirms the treaty in an instrument of ratification. At that point, under Article VI of the Constitution the said treaty "shall be the supreme Law of the Land." Daniel Patrick Moynihan, *On the Law of Nations*, Harvard University Press, 1990, pp. 173-74.

This "singularly exacting" process gives great significance to the adoption *or* the rejection of a treaty. When the Senate gives its advice and consent to a treaty and it is ratified, the treaty becomes the supreme law of the land and the policy of

the United States. When the Senate refuses to give its advice and consent to a treaty, its provisions do not become the supreme law of the land, and the policy which the treaty represents can no longer be used to nullify state law. If this were not so, the President could establish the supreme law of the land *ex cathedra* regardless of the Senate's views. There would be no need for the Senate's advice and consent. The reasons for this balance of powers are found in the circumstances which gave rise to the adoption of the Constitution.

One of the major motivations for the adoption of the Constitution was the need to create a central government which could deal with other nations on an equal footing in the area of commercial relations. To this end, the power to make treaties was granted solely to the federal government. U.S. Const., art. I, § 10, cl. 1 and art. II, § 2, cl. 2.

The delegation of the treaty power to a federal government, while recognized as necessary, was viewed with trepidation. States, which under the Confederation were sovereigns with their own power to enter into treaties, were concerned that the delegation of this power to the central government would result in their interests being disregarded. Consequently, the structure of the government was designed to prevent this occurrence. The Senate, one of the two bodies contained in the Legislative Branch, was created as a representative of the States with each State having equal rights of representation. Furthermore, this right of equal representation could not be changed without the consent of the affected State. U.S. Const., art. V.

This Court, in recounting the history of the Commerce Clause, has recognized that protection of the sovereignty of the States is provided by the very structure of our federal government. This Court's Commerce Clause discussion is

even more apt with respect to the exercise of the treaty power. In *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), this Court stated:

> . . . Apart from the limitation on federal authority inherent in the delegated nature of Congress' Article I powers, the principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government itself. It is no novelty to observe that the composition of the Federal Government was designed in large part to protect the States from overreaching by Congress. [footnote omitted] . . . They were given more direct influence in the Senate, where each State received equal representation and each Senator was to be selected by the legislature of his State. [citation omitted] The significance attached to the States' equal representation in the Senate is underscored by the prohibition of any constitutional amendment divesting a State of equal representation without the State's consent. [citation omitted]
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> The extent to which the structure of the Federal Government itself was relied on to insulate the interests of the States is evident in the views of the Framers. James Madison explained that the Federal Government "will partake sufficiently of the spirit [of the States], to be disinclined to invade the rights of the individual States, or the prerogatives of their governments. (citation omitted)" . . . "it was a favorite object in the Convention" to provide for the security of the States against federal encroachment and that the structure of the Federal Government itself served that end. [citation omitted] . . . equal representation of the States in the Senate, which he saw as "at once a constitutional recognition of the portion of sovereignty remaining in the individual States, and an

> instrument for preserving that residuary sovereignty." [citation omitted] . . . "the residuary sovereignty of the States [is] implied *and secured* by that principle of representation in one branch of the [federal] legislature" [citations omitted] . . . the Framers chose to rely on a federal system in which special restraints on federal power over the States inhered principally in the workings of the National Government itself, rather than in discrete limitations on the objects of federal authority. State sovereign interests, then, are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power.
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> We realize that changes in the structure of the Federal Government have taken place since 1789, not the least of which has been the substitution of popular election of Senators by the adoption of the Seventeenth Amendment in 1913, and that these changes may work to alter the influence of the States in the federal political process. [footnote omitted] Nonetheless, against this background, we are convinced that the fundamental limitation that the constitutional scheme imposes . . . is one of process rather than one of result.
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>
> . . . [T]he principal and basic limit on the federal commerce power is that inherent in all congressional action — the built-in restraints that our system provides through state participation in federal governmental action. The political process ensures that laws that unduly burden the States will not be promulgated. In the factual setting of these cases the internal safeguards of the political process have performed as intended. *Garcia*, 469 U.S. 550-556.

Concerns for the sovereignty of the States were expressed through the Constitutional requirement that the Senate, by two-thirds of its members present, give its advice and consent to a treaty, U.S. Const., art. II, § 2, cl. 2. In this regard, our Constitution differs markedly from the structure of government in the United Kingdom, and most other national governments in the world, where the conduct of foreign affairs is left almost exclusively in the hands of the Executive Branch. It should not be forgotten that in designing the structure of our constitutional system, the Framers had, as a model they wished to avoid, the government of the United Kingdom.

In the debate which occurred on the Senate floor during the consideration of the US/UK treaty, Senator Frank Church recalled the concerns of our founding fathers as follows:

> There are two important principles at stake in this treaty. The first concerns the role of tax treaties in our constitutional system. Whatever tax treaties are good for, they should not be used to usurp for the executive branch of Government the power to impose major changes in internal tax policy. Yet, the United Kingdom Treaty does precisely this.
>
> For some ten years, Congress has been rejecting the type of limitation on the power of our State governments to tax which is incorporated in article 9(4) of the pending treaty.
>
> * * *
>
> The second important principle concerns the proper way for resolving disputes with our federal system. . . . the States were never consulted before their tax powers were bargained away. . . .
>
> . . . Congress is the forum in which disputes with the federal system [are] meant to be resolved. . . .

> . . . The original purpose for the Senate's role in the treaty process was to protect the interests of the several States in treaty matters. The framers feared that to give the executive branch of the Federal Government free rein in the treaty process would enable the President to ride roughshod over the States. We may have waited a while to see that fear confirmed, but that is exactly what article 9(4) of this treaty does. It demonstrates that the fears of the framers of our Constitution were well founded. 124 Cong. Rec. S. 18416-18417, June 22, 1978.

The failure of the United Kingdom to appreciate this fundamental difference in the form and structure of our government may explain its concerns with respect to what happened to the bilateral tax treaty which we negotiated with it, but it does not give the United Kingdom the power to dictate how our system ought to function or how this Court should construe our institutional framework. One of the primary concerns of the Framers was to preserve the individual sovereign rights of the States. The fact that the United Kingdom does not share these concerns is of little moment in this Court's interpretation of the Constitution and the significance of acts taken pursuant to its requirements.

III. THE CALIFORNIA BUDGET AND TAX CODE ARE THE HEART OF THE STATE'S POLITICAL PROCESS AND SHOULD NOT BE SET ASIDE ABSENT SPECIFIC FEDERAL LEGISLATION OR TREATIES.

Even when the federal government has legislated, it does not follow that State legislation on the same subject is automatically preempted. The test requires the presence of persuasive reasons ". . . either that the nature of the regulated subject matter permits no other conclusion or that Congress has unmistakably so ordained." *Florida Lime and Avocado*

Growers v. Paul, 373 U.S. 132, 142 (1963). Indeed, this Court sustained a State tax that differed from the federal tax, even when Congress thought State law would follow federal law, because Congress did not *require* States to follow federal law. *Amerada Hess Corp. v. New Jersey*, 490 U.S. 66, 70 (1989). In this case, Congress has refused to legislate and the Senate refused to ratify the treaty which would have preempted the State law at issue in these cases.

In this case, multinational corporations and foreign governments are asking this Court to use the Commerce Clause of the Constitution, art. I, § 8, cl. 3, and the so-called "Dormant Commerce Clause analysis" to nullify a State law for foreign policy reasons. They cite the anger of foreign governments, including, in the case of several foreign government *amici*, their own protests. They argue that there is a constitutional requirement that the United States "speak with one voice" on foreign commercial issues and that, absent federal legislation or treaties, this Court is that voice.

In the process, Petitioners are asking this Court to take the drastic step of nullifying California's political decisions that could cost California's taxpayers over $4 billion in tax revenue losses. The refunds, and the additional loss of revenue to the State treasury, will force the State to weaken its infrastructure, will put its wholly domestic companies at a competitive disadvantage, and will force a reallocation of benefits and burdens which have already been distributed, after bitter budget debate, by the California Legislature. It will come at a time when California is reeling from the impact of wildfires and now earthquakes. Each of these events by itself sends tremors through a state's budget. Cumulatively, these events will have the fiscal impact of an earthquake of at least 9.0 on the Richter scale.

What impact does $4 billion have on California's budget? In terms of services, it means, for example, the loss of ability to pay for over 100,000 teachers, send 1 million college students to State universities, or provide health coverage for over 5 million uninsured Californians. Based on current proportions in the budget, elementary and secondary education would lose $1.6 billion, higher education would lose $480 million, and health and welfare programs would lose about $1 billion. In a State which has struggled to provide basic services and resolve on-going budget deficits, it would be a staggering blow to its ability to maintain the level of public services which have contributed so much to the environment which foreign multinationals have sought.

Alternatively, the impact on California's other taxpayers would be devastating. To replace the $4 billion would mean an increase in personal income taxes of 25 percent on all taxpayers for one year. It would mean an increase in State sales taxes of 30 percent, or 2 1/2 cents. It would mean an increase of approximately 80 percent in the Bank and Corporation tax for wholly domestic companies while allowing multinational corporations to essentially escape the tax. Indeed, if Barclays and Colgate prevail, our wholly domestic companies will have to compete against multinational corporations which pay no income taxes whatsoever on their exports to the U.S. because in many countries there is no corporate income tax, only a Value Added Tax on products which is rebated to a corporation once it exports the product.

Thus, the potential costs to the State of California will be significant for every citizen and taxpayer. Either California must shift the tax burden from multinational corporations to wholly domestic corporate and individual taxpayers, or make significant cuts in vital public services thereby weakening one

of the very features which benefitted these multinational investors in the first place.

Who would be hurt by such a decision? The damage caused will be most obviously to all taxpayers and to public services, but, in addition, will disadvantage wholly domestic, small and local businesses. The prohibition of an effective method of tax enforcement — WWCR — gives multinational corporations a tax shelter that is not available to wholly domestic companies, whose income is apportioned by formula.

Barclays and Colgate demand all of this despite their failure to prove that the WWCR method is discriminatory, despite their failure to prove that the WWCR method will, in fact, result in double taxation, and despite their failure to prove that the method is burdensome. Barclays' and Colgate's real complaint is that they do not want to pay taxes. They want to continue to be able to shelter income in tax havens such as the British Crown Colony of the Cayman Islands which is now the fifth largest banking center in the world.

This court should respect us as citizens and taxpayers and protect our budget process from foreign assault. It should not allow itself to be used by multinationals as a tool to undermine our Nation's fundamental democratic institutions.

Further, we believe that the language in the *Container* case, 463 U.S. 159, at 194 (1983), which suggests that if there is a credible threat of foreign government retaliation, it may be appropriate for this Court to use foreign policy as a reason to nullify State law, under the Commerce Clause, should be disclaimed. The language opens the door to foreigners who will make threats just to reenforce their "Dormant Commerce Clause" arguments. The threats will give foreign governments a stronger hand in shaping state fiscal policy than we give our own citizens.

CONCLUSION

For the foregoing reasons, *amici curiae* urge this Court to affirm the decisions of the California courts.

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Respectfully submitted,

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